

WORLD ECONOMIC SURVEY*

WORLD ECONOMIC CLIMATE BRIGHTENS

In July 2003 the World Economic Climate continued its recovery, which had begun in January but was interrupted by the escalation of the Iraq crisis in March and early April, (see Figure 1). At 91.3, compared with 83.2 in the previous survey, the climate indicator is now approaching its long-term average (1989 – 2002: 93.7). The assessment of the current economic situation remained at an unsatisfactory level, whereas the expectations for the next six months clearly brightened.

World economy: Start of a recovery?

In July 2003, the renewed upward movement of the economic climate index, which had already set in by the end of April became more apparent.¹ It is still too early, however, to interpret this improvement as the onset of a global economic recovery. For such an assertion experience dictates several positive survey results of both, assessments of the economic situation and economic expectations for the next six months. Whereas, according to the latest survey results, the assessments of the current economic situation remained below satisfactory on the world average, mostly reflecting the deterioration in the United States and Western Europe, the economic expectations for the next six months clearly picked up. Thus, in the majority of the other countries polled, the chances for an economic upturn are on the horizon.

* The survey is jointly conducted by the Ifo Institute and the Paris-based International Chamber of Commerce (ICC).

¹ A separate analysis of survey data that came before and after 15 April 2003 showed striking differences. In the first group, the world economic climate was significantly lower than in the January survey (79.6 compared to 85.9). In the second group, i.e. responses submitted after April 15, the overall indicator stood at 86.8 and thus slightly higher than in January 2003 (85.9).

For the interpretation of the current improvement of the economic climate a review of its development over the last two years can offer valuable clues. In October 2001, after the terrorist attacks in the United States, the economic climate indicator reached an all-time low. In January and April 2002 the overall indicator bounced back, mainly driven by optimistic expectations. However, at this stage apprehension that this improvement of the indicator was not yet signaling the onset of a world-wide recovery proved true, and in July and October 2002 the world economic index slipped into a “double dip”. This new strong setback of the economic climate was mostly due to the escalation of the Iraq crisis. With the end of the main war activities in Iraq on April 9, the economic expectations clearly brightened compared to the period of the looming geopolitical crisis in 2002 and the beginning of 2003. This positive trend of economic expectations gained momentum in July, but as mentioned, it is still too early to draw conclusions concerning the strength of the upturn.

United States: Economic climate improves

In the United States, the assessments of the current economic situation remained almost unchanged, while the economic expectations became clearly optimistic. The war economy accompanied by high

Figure 1

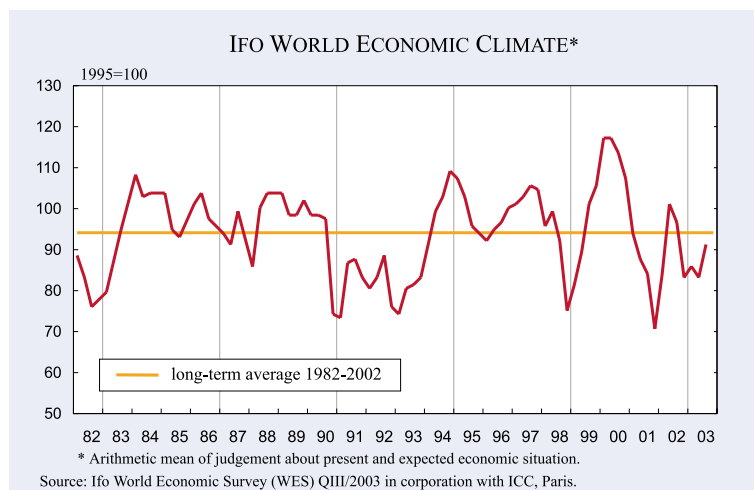
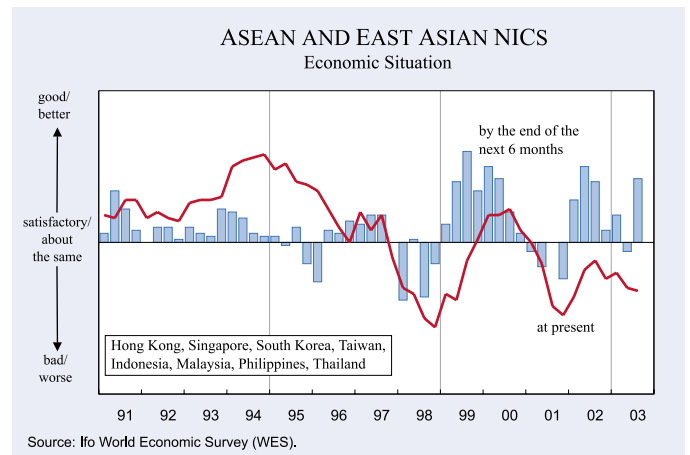
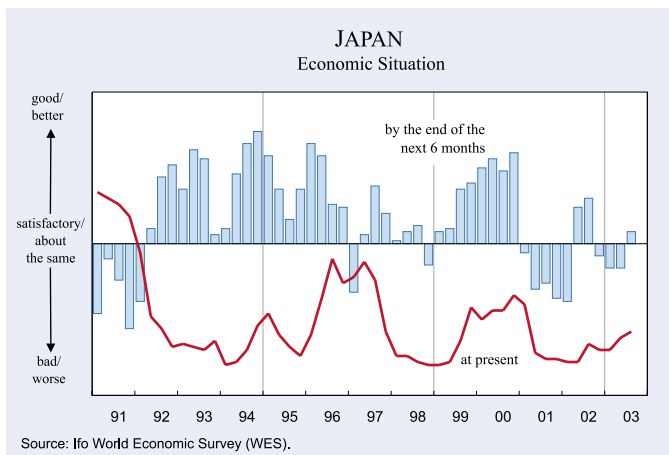
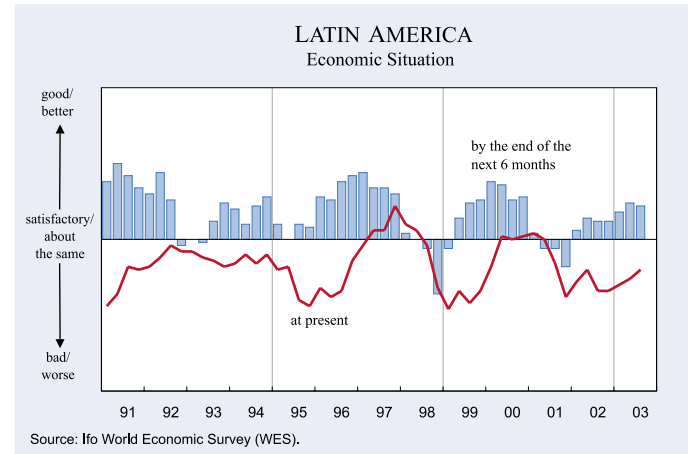
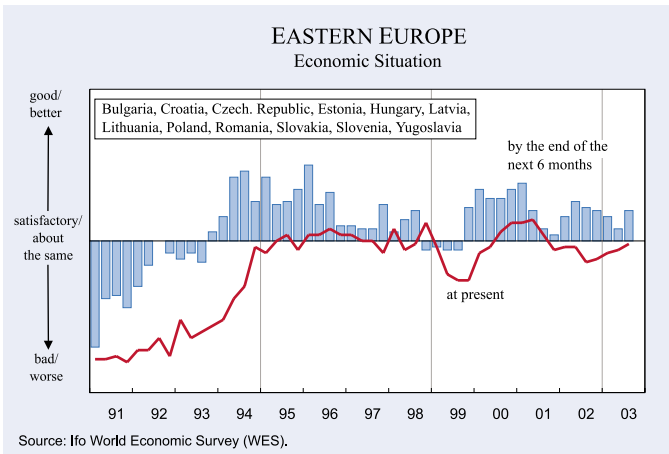
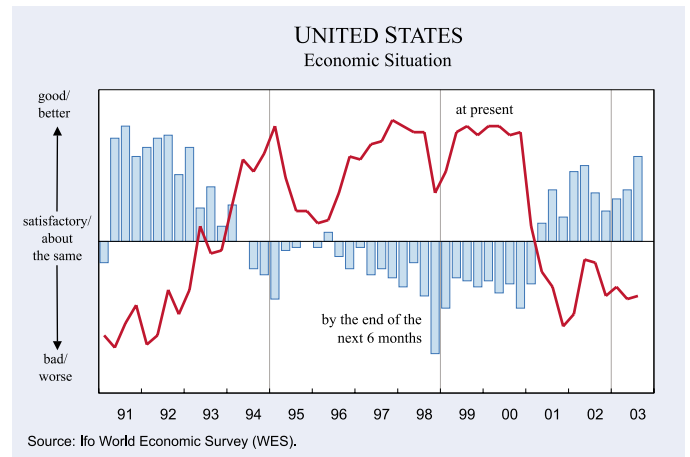
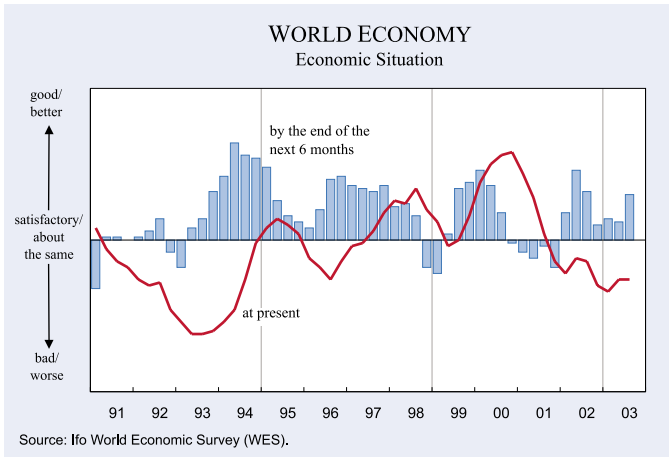


Figure 2



public deficits has strained the economic climate in the U.S. Accordingly, economic performance remained weak in July, whereas the optimistic expectations reflect the hope for a post-war recovery in business sentiment. In particular, capital expenditures and private consumption are expected to improve. (Fig. 2).

European Union: Economic climate indicator rises slightly

The assessment of the current economic situation in most Western European economies remained below satisfactory. However, expectations for the next six months improved relatively strongly in almost all European countries (see Figure 3).

The lowest marks for the current situation were given by WES correspondents in *Portugal*, *Germany* and the *Netherlands*. Economic performance also remains weak in other countries, with *Finland*, *Greece*, *Luxemburg* and *Spain* being positive exceptions. The near-term prospects generally became positive in all EU countries with the exception of *Ireland*, where WES correspondents expect the slowdown of economic growth to continue in coming months. Despite the continued appreciation of the euro, sentiments regarding the export outlook became more optimistic in almost all countries of the euro area, except *Belgium*, *Ireland* and *Spain*. Among the non-euro countries, *Denmark* and *the United Kingdom* appear to be faring significantly better economically than all the other European countries, with a bright outlook for the next six months.

Eastern Europe: Favourable economic climate continues

Having been almost unaffected by the general economic downturn in Western Europe during 2002, the economic climate in Eastern Europe remained favourable also in July 2003 (see Figure 2).

The majority of Eastern European economies have shown considerable robustness in recent years, despite their thorough restructuring processes. In particular in the Baltic States – *Estonia*, *Lithuania* and *Latvia* – WES experts have considered the economic situation to be on a highly satisfactory level for two years now. The outlook for the com-

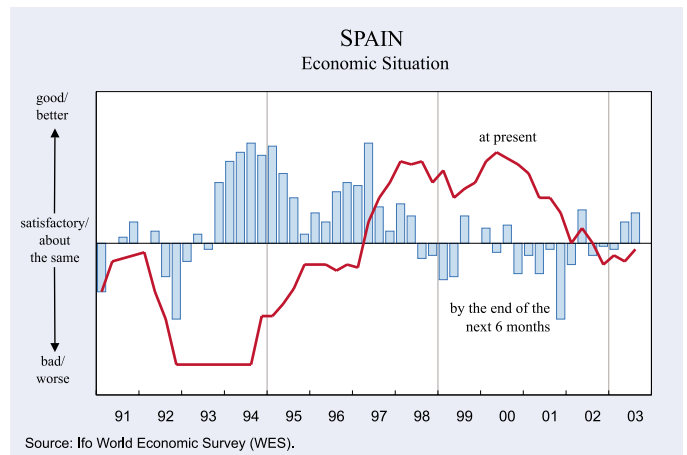
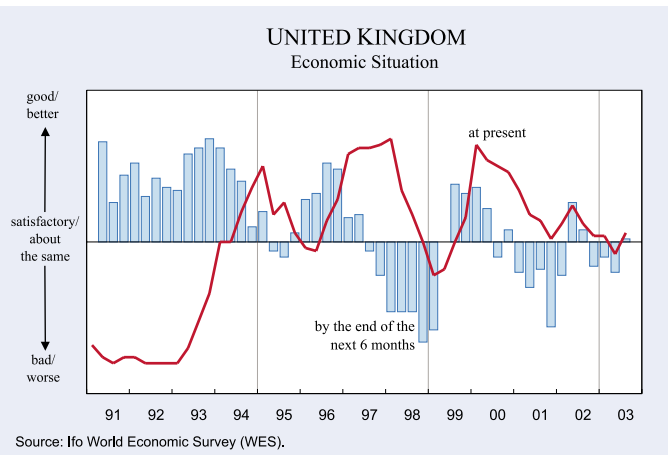
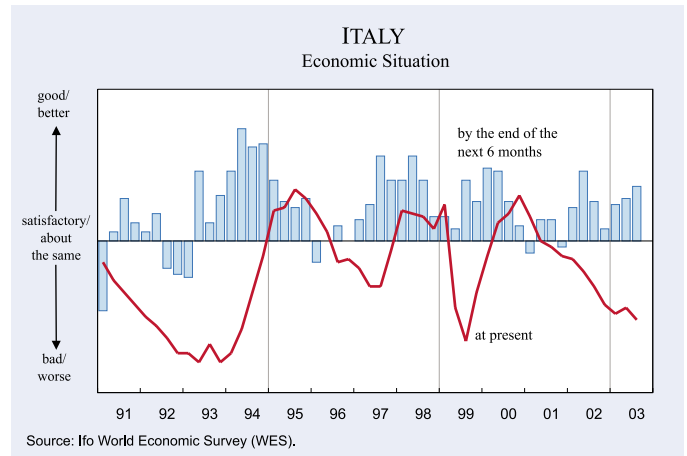
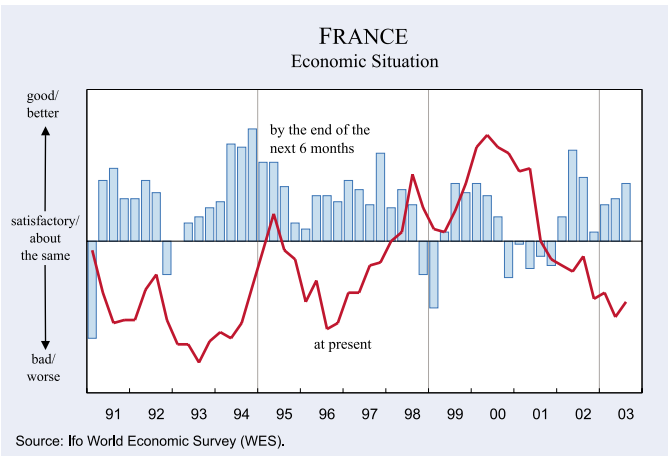
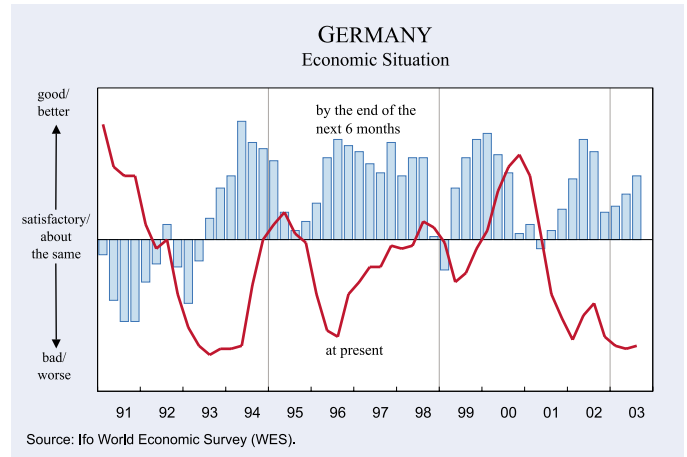
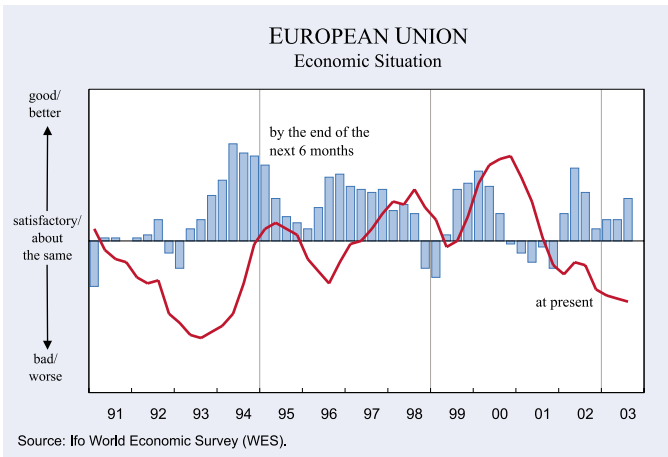
ing six months suggests stabilisation of these economies at the current “good” level. In *Slovenia*, *Slovakia*, *Albania*, *Bulgaria* and the *Czech Republic* the present economic situation was assessed as “satisfactory” with prospects remaining highly positive. To a lesser degree this holds true for *Poland*, where the depressed overall economic climate does continue to improve. In *Croatia* and *Serbia/Montenegro* WES experts considered the present economic situation to be below the “satisfactory” level. In *Croatia*, no major changes are expected in capital expenditures and private consumption, whereas the export sector could strengthen in the coming months. In *Serbia/Montenegro* the overall outlook is for an improvement. The assessments of the current economic situation in *Romania* and *Hungary* worsened in July and are now also slightly below the “satisfactory” mark. Fixed investment is predicted to remain stable, whereas exports are expected to pick up in coming months.

Latin America: Economies expected to pick up

According to the recent survey, both the assessment of the current economic situation and the expectations for economic developments in the next six months promise an improvement of the economic climate in South America. However, the vast majority of WES experts surveyed in this region judged the present economic situation of their country to be below a “satisfactory” level (see Figure 2).

In *Brazil*, the largest economy in this area, the economic climate – though slightly less favorable than in the previous survey – will remain very moderate in the coming six months. Fixed investment, consumption and in particular exports are expected to strengthen by the end of the year. In *Chile* the assessment of the current economic situation has left the negative range, and expectations for the next six months improved even more. Growth of domestic demand is expected to become more dynamic. Positive assessments of the present economic performance came also from *Peru*. The panel’s forecast for the coming six months reflects a stabilisation of the current positive state. In *Colombia* the economic situation had already shown signs of recovery in the four preceding polls. In the April survey the assessments of the current economic performance almost reached the “satis-

Figure 3



factory” level. The optimistic expectations for the next six months, in particular in the export sector, give hope for a continuation of this positive trend. Not satisfactory but somewhat better than the Latin American average is the economic climate in *Mexico*. Since the beginning of 2003 the economic situation has slightly improved and was considered close to satisfactory in April. This trend will continue in the coming months, reflecting a rather stable state of the economy.

In *Argentina*, the long-expected recovery from the economic crises has become more dynamic, according to the recent survey results. The assessments of the current economic situation are better than in the previous two surveys, though far below the satisfactory level. Exports are expected to pick up strongly in the coming months, as will private consumption and capital expenditures.

In other countries of the region, in particular in *Panama*, *Paraguay* and *Uruguay*, the assessment of the current economic situation fell below “satisfactory”. But as in the April survey, stronger economic growth is forecast for the coming months. Less encouraging is the assessment of the present economic situation in *Bolivia*, *Ecuador* and *Venezuela* where the short-term expectations also point to further deterioration. In *Bolivia* and *Ecuador*, the export sector provides some impetus for more dynamic growth. *El Salvador* is the only country in the region in which WES experts expect the currently satisfactory economic situation to deteriorate considerably in the coming months.

Asia: Economic climate indicator bounces back

In the April survey the Asian region as a whole had registered the strongest deterioration of the economic climate indicator compared with other regions of the world. In the July survey, however, the economic climate improved considerably and even slightly surpassed its long-term average. The recent pick-up is mostly attributed to the optimistic expectations in all WES countries of the region for the coming six months. The positive impetus most likely derived from the fast containment of the SARS epidemic.

In *Japan* the depressed economic situation still shows only weak improvement, according to WES

experts. Expectations for the next six months did turn positive again, however.

In *Thailand* the present economic situation as well as economic expectations remained at a high level, with capital expenditures, private consumption and the export sector expected to grow in the course of the next six months. In *Malaysia* the present economic situation remained almost unchanged, judged slightly above satisfactory, and economic expectations are for positive changes in the course of the next six months. In the *Philippines* the current economic situation reached the “satisfactory” level and is expected to continue its stabilisation course. The current economic development in *Singapore* changed for the better, confirming the optimistic expectations of the previous surveys.

In *Indonesia*, *South Korea* and *Taiwan* our panel’s responses concerning present economic performance remained in the negative range in July. The outlook for the next six months is lackluster in *Indonesia* and *South Korea*, but is positive in *Taiwan*. In *Hong Kong* the current economic performance deteriorated. The private consumption sector, which felt the negative impact of the SARS epidemic most, is expected to recover, however, as is the overall economy in the coming months.

Inflation: Slowdown expected

World-wide consumer price inflation is now expected to be 2.8 percent in 2003, significantly lower than the estimate in the previous two surveys (3.2 percent). In the *Euro area*, the 2003 inflation rate is now seen, for the first time, below the 2 percent mark (1.9 percent compared with 2.1 percent in the April survey). A higher inflation rate than that of the April survey is only expected in Italy (2.6 percent compared with 2.4 percent). *Switzerland* and *Germany* remain the two countries with the lowest expected inflation rate in Western Europe (0.7 percent in the case of Switzerland and 1.1 percent in the case of Germany).

At 2.0 percent, expected 2003 inflation figures in the *United States* are lower than in the April survey (2.3 percent). Thus, the disinflation process appears to continue in the second half of this year. Asia still shows by far the highest degree of price stability (1.1 percent compared to 1.4 percent in April 2003). Deflationary trends still prevail in *Japan*

(unchanged at – 0.5 percent in 2003) and *Hong Kong* (– 1.6 percent compared with – 1.1 percent in April). Also in *Taiwan*, where consumer prices are expected to stagnate in 2003, the danger of slipping into a deflationary cycle is still not completely averted.

The 2003 inflation outlook for *Central and Eastern Europe* remained unchanged (4.3 percent). The only countries in this bloc still having very high inflation rates are *Romania* (14.2 percent), *Serbia/Montenegro* (8.9 percent) and the *Slovak Republic* (8.4 percent).

In *Central and Latin America* expected overall inflation is now somewhat lower than in the April survey (9.0 percent compared with 10.7 percent). By far the highest inflation rate in this region still prevails in *Venezuela* (45.8 percent) though here, too, the inflation trend is expected to slow down somewhat. The inflation outlook for *Africa* is worsening (17.4 percent after 14.6 percent in the April survey). However, this is mainly due to the catastrophic situation in *Zimbabwe* where a hyperinflation of now about 525 percent is expected in 2003, following a rate of about 135 percent last year. In *South Africa* 2003 inflation is expected to settle at 7.3 percent (compared with 8.3 percent in the April survey), down from 9.5 percent in 2002.

Interest rates: Further decline expected

More WES experts than in the previous three surveys expect a further decline of **short-term interest rates**. In *North America* (in *Canada* even more so than in the *United States*), the previously expected rise of short-term rates in the course of the next six months has now been replaced by an expected trend of stable or even slightly declining rates. In *Australia*, confirming the results of the previous survey, short-term interest rates began to fall and are expected to level off further in the course of the next six months. In *Western and Eastern Europe* the downward trend of short-term interest rates is still intact and expected to continue in coming months. Thus, the participants from the Euro area think a further monetary easing by the European Central Bank to be likely. In *Africa*, particularly in *South Africa*, panellists still see a high likelihood of rate cuts in coming months. In *Latin America*, too, the trend of rising short-term interest rates appears to be broken; in the months to come, short-term interest rates are expected to

decline somewhat, with the exception of a few countries like *Colombia* and *Venezuela*.

Long-term interest rates are expected to remain stable in the coming six months or even decline somewhat following the sharp increase in previous weeks. This world-wide trend also characterises *Western Europe* and the *United States*. In *Canada* and *Australia*, where – in the April survey – a pronounced increase of long-term interest rates was correctly anticipated, the trend of bond rates in the coming six months is now expected to level off. In *Latin America*, WES experts see room for a decline of long-term interest rates, particularly in *Brazil*. In *Asia*, bond rates are expected to remain stable or decline somewhat, with the exception of *Japan* where the increase of rates is expected to continue. In *Eastern Europe*, long-term interest rates are expected to also exhibit a falling trend in the coming six months.

Currencies: Euro seen to be overvalued

The euro is considered overvalued – even more so than in the previous survey. The degree of overvaluation is now almost as pronounced as in the case of the British pound sterling. Correspondingly, the US dollar is said to be undervalued for the first time in about five years. The current level of the Japanese yen is assessed as more or less appropriate, with a small bias toward undervaluation.

The perceived overvaluation of the euro is a widespread phenomenon, particularly pronounced in North America. The US dollar is seen as undervalued against own currencies particularly in Western and Eastern Europe as well as in Latin America. The own currency appears to be generally undervalued in *Canada*, *Australia*, *New Zealand*, *Estonia*, *Latvia*, *Serbia/Montenegro*, *Saudi Arabia* and *Colombia*. On the other hand, the own currency is seen as generally overvalued particularly in *Venezuela*, *Nigeria*, *Turkey* and again most pronouncedly in *Zimbabwe*.

In addition to the general assessment, WES experts were again asked about the likely trend of the US dollar exchange rate in the next six months. On average for all 91 countries covered, the US dollar is expected to gain in value. The main exceptions from this general trend are *Australia* and *New Zealand* as well as *Norway*.